

Internal Revenue Service

Number: **201528010**

Release Date: 7/10/2015

Index Number: 115.00-00, 115.03-00

Department of the Treasury

Washington, DC 20224

Third Party Communication: None

Date of Communication: Not Applicable

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CC:TEGE:EOEG:EO

PLR-128238-14

Date:

January 20, 2015

Legend

Act	=
Corporation	=
Hospital	=
School	=
State	=
A	=
B	=
x	=
y	=

Dear :

This letter responds to a letter from your authorized representative dated June 30, 2014, and subsequent correspondence submitted on behalf of Corporation, requesting a ruling that the Corporation's income is excludable from gross income under Internal Revenue Code (IRC) §115. Corporation represents the facts as follows.

FACTS

A is a State university.

B is an integral part of State. B owns and operates the Hospital, a teaching hospital. B was established under the Act, which provides that provision of health care services is an essential governmental function that protects and promotes the health and welfare of the citizens of State. Additionally, the Act provides that the education of medical and health science professionals and the performance of medical and related research are essential to promote this essential governmental function.

A operates the School. Different foundations conduct the business operations of each of the School's x departments. The foundations further A and B's purposes by providing the education and research faculty for A and the medical staff for the Hospital.

A, B, and the foundations determined that their respective missions in a changing healthcare environment could be better served by combining the foundations into the Corporation. Accordingly, A and B formed the Corporation to provide a more strategically, financially, and clinically integrated clinical enterprise; to more effectively sustain the public and charitable missions of A and B; and to unite and align the interests of all physicians currently employed by the foundations into a single physician organization. Like the foundations, the Corporation will provide an integrated faculty group practice for the delivery of high quality, cost-effective, patient care. The Corporation will provide the clinical faculty for the School and the medical staff for the Hospital.

The Corporation's principal activities will be providing clinical services to the Hospital's patients, regardless of their ability to pay, and facilitating and supporting A's educational, research, and public service missions. The Corporation will pay the physicians' salaries with respect to the provision of medical care to the Hospital's patients. Physician compensation will be reasonable and consistent with fair market value.

The Corporation has two classes of common stock, neither of which has any pecuniary value. Additionally, neither class will earn dividends. A holds y shares of one class, and B holds y shares of another class. A and B are the only authorized shareholders; no other organization, government entity, or natural person may be a shareholder. Neither A nor B may sell or transfer shares without the approval of all shareholders and the Corporation's board of directors.

The Corporation may be dissolved only upon consent of both A and B. Upon dissolution, any remaining assets will be paid to the State, to a political subdivision of the State, or to an organization whose income is excluded from gross income under IRC §115.

LAW AND ANALYSIS

IRC §115(1) provides that gross income does not include income derived from any public utility or the exercise of any essential governmental function and accruing to a state or any political subdivision thereof.

Rev. Rul. 77-261, 1977-2 C.B. 45, holds that income generated by an investment fund that is established by a state to hold revenues in excess of the amounts needed to meet current expenses is excludable from gross income under IRC §115(1), because such investment constitutes an essential governmental function. The ruling explains that the

statutory exclusion is intended to extend not to the income of a state or municipality resulting from its own participation in activities, but rather to the income of an entity engaged in the operation of a public utility or the performance of some governmental function that accrues to either a state or political subdivision of a state. The ruling points out that it may be assumed that Congress did not desire in any way to restrict a state's participation in enterprises that might be useful in carrying out projects that are desirable from the standpoint of a state government and that are within the ambit of a sovereign to conduct.

Rev. Rul. 90-74, 1990-2 C.B. 34, holds that the income of an organization formed, funded, and operated by political subdivisions to pool various risks (e.g., casualty, public liability, workers' compensation, and employees' health) is excludable from gross income under IRC §115(1) because the organization is performing an essential governmental function. The revenue ruling states that the income of such an organization is excluded from gross income so long as private interests do not participate in the organization or benefit more than incidentally from the organization. The benefit to the employees of the insurance coverage obtained by the member political subdivisions was deemed incidental to the public benefit.

A, a State university, and B, an integral part of the State, created the Corporation to assist A and B in fulfilling their respective governmental purposes and to perform services that would otherwise be performed by A or B. The Corporation is necessary to integrate B's obligation to provide health care services in the State and B's obligation to educate healthcare providers and scientists and conduct research in the State. Specifically, the Corporation provides clinical services to the patients of B's subsidiary, the Hospital, regardless of the patients' ability to pay. The Corporation also facilitates and supports A's educational, research, and public service missions. Engaging in such activities constitutes the performance of an essential government function within the meaning of IRC §115(1). See Rev. Rul. 90-74 and Rev. Rul. 77-261.

No private interests will participate in, or benefit from, the operation of Corporation other than as providers of goods or services. The benefit to the physicians employed by the Corporation is incidental to the public benefit. See Rev. Rul. 90-74.

In accordance with the Corporation's Articles of Incorporation, in no event, including dissolution, will the Corporation's assets be distributed to, or revert to, any entity that is not the State, a political subdivision of the State, or another entity the income of which is excluded from its gross income by application of IRC §115.

Based solely on the facts and representations submitted by the Corporation, we conclude that:

Because the income Corporation derives is from the exercise of an essential governmental function and will accrue to a state or a political subdivision thereof, the Corporation's income is excludable from gross income under IRC §115(1).

This ruling is based on the representation that the Corporation intends to adopt certain proposed changes to its Articles of Incorporation in a timely manner.

No opinion is expressed concerning the Federal tax consequences under any IRC provision other than the one specifically cited above. In particular, no representation is made that contributions or premiums paid on behalf of or benefits received by employees, former employees, retirees, spouses, dependents or others will be tax-free. This ruling concerns only the Federal tax treatment of Trust's income and may not be cited or relied upon as to any matter relating to the taxation of accident or health contributions or benefits.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

This ruling is directed only to the taxpayer requesting it. IRC § 6110(k)(3) provides that it may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

The ruling contained in this letter is based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

Sincerely,

Casey Lothamer
Senior Technician Reviewer
Exempt Organizations
(Tax Exempt & Government Entities)

cc: